

# Geopolitical Rivalry and Economic Security: Changing Incentives for Regional Cooperation?

Bernard Hoekman (European University Institute)

April 23, 2014

Prepared for the ERF 2024 annual conference session “Re-localization and Regional Cooperation in an increasingly shock prone global economy”, Rabat, April 21-23.

# Multiple sources of major shocks

- International:
  - 2008 GFC; COVID-19 pandemic; Russia's war against Ukraine and resulting food and fuel crisis
  - Ongoing climate change and associated rising temperatures and water shortages
- Regional:
  - 2010-12 Arab 'spring'; civil wars and regional conflicts (Iraq, Libya, Syria, Yemen, Lebanon, Palestinian territories); 2023 Israel-Hamas war
- Addressing (reducing) regional differences and conflicts would attenuate a major source of adverse shocks and associated disincentives for investment
- Focus here on question whether shift in focus towards national and economic security in major global economic powers offers opportunities

## Changing international context...

- The post-WWII rules-based order supported reforms that drove large increases in GDP per capita and human development
- Global value chains leveraging trade cost reductions from ICT and transport innovations permitted firms to specialize and invest across borders
- As tariffs were reduced and GVCs expanded, domestic regulatory policies more central
  - Firms push for measures to lower trade costs of regulatory heterogeneity
  - Voters/consumers: condition trade and investment on values reflected in domestic regulation
- Regulation reflects mix of economic and noneconomic objectives (NEOs)
  - Competitiveness/fair trade; combat climate change; safeguard national security
  - Rising geopolitical rivalry making security once again central – export controls; FDI control
- Trade and investment impacted by perceived need to “de-risk” trade/supply chains via, i.a.
  - Diversification to bolster resilience & reduce threat of weaponization of trade
  - Regulation: mandatory due diligence of compliance with production process standards & values
- Shift to large-scale subsidization of investment in local production facilities (EVs, batteries, semiconductors, etc. and associated inputs/critical supplies)

## ... is driving changes in approaches to addressing policy spillovers

- Rising recourse to (aggressive) unilateralism creates negative spillovers
  - EU: CBAM, deforestation, foreign subsidies regulation; US: Inflation Reduction Act subsidies
- Shift from broad multilateral trade to domain-specific cooperation among “friends”
- Preferential trade agreements (PTAs), long an instrument to enhance (reciprocal) market access, increasingly loci for rule-making on behind the border policies
  - US a major outlier, shifting to a “we want trade policy space” stance
  - East Asia now leader in negotiating new mega-regional PTAs – CPTPP, RCEP
  - African market integration through implementation of the AfCFTA
- PTAs beginning to be complemented by issue-specific bilateral/plurilateral agreements
  - Mutual recognition/equivalence arrangements, e.g., EU data adequacy decisions
  - Digital economy partnerships (East Asia)
  - Indo-Pacific Economic Framework (East Asia)
  - Essential supplies/critical minerals
- Also at the WTO: Plurilateral initiatives on services domestic regulation, investment facilitation; e-commerce ; trade/environment, etc.

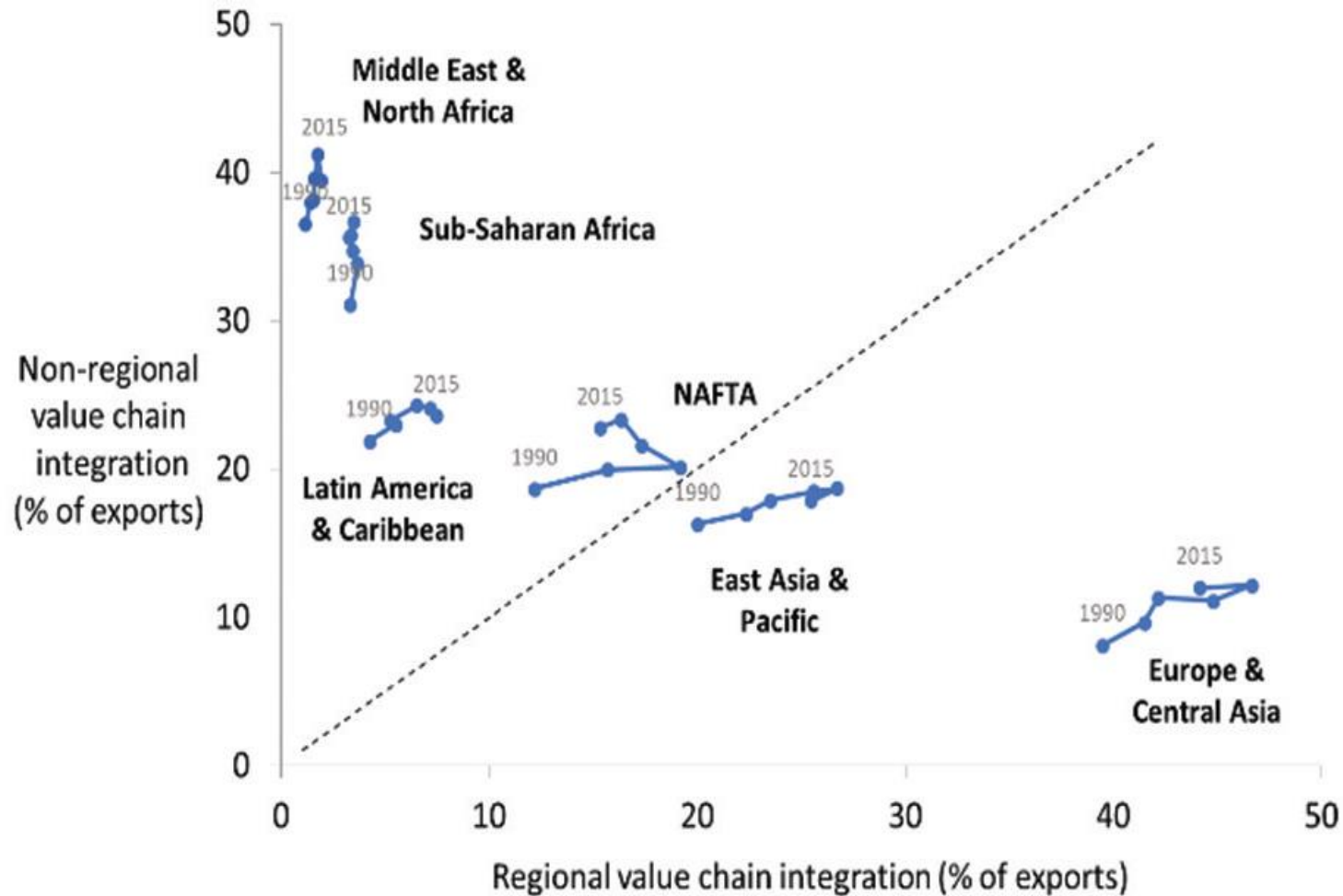
# Do these developments offer an opportunity to the region?

- E.g., to support security/resilience/diversification goals by offering location for GVC-focused FDI seeking to reduce dependence on/presence in China?
  - Maghreb as a location for GVC production of goods & services for EU/AfCFTA countries
  - GCC – leveraging logistics/transportation/services hubs as production platforms for regional as well as Africa/EU/ROW markets
- E.g., as a supplier of clean(er) energy and natural resources
  - Gas; Electricity; Critical minerals
- Not a new idea—there are already initiatives in some of these areas
- Questions:
  - What need for regional cooperation, as opposed to national action, or forming/joining extra-regional plurilateral initiatives/clubs seeking to attain shared noneconomic objectives?
  - Can such plurilateral cooperation help overcome regional divisions and internal conflicts by generating meaningful increases in economic activity and employment as opposed to rents/FX?
  - Does such cooperation need to be embedded in a well-functioning trade agreement?

# Arab countries and deep trade cooperation

- Focus has been on removing tariffs on goods; limited focus on services/regulation
- Outside GCC, resistance/opposition to deep PTAs. Excluding the GCC, Arab countries account for 7 of 250+ deep PTAs that cover services; only 4 cover investment policy
- Track record with top-down institution-focused integration initiatives is very mixed
  - Spectrum ranges from GCC to Arab Maghreb Union, with Arab League/PAFTA in between, limited to shallow integration centred on tariff removal
- Arab nations are mostly not participating in ongoing talks in WTO on e-commerce, services domestic regulation, investment facilitation and micro/SMEs
  - E-commerce: Five of the six GCC countries participate (Bahrain, Kuwait, Qatar, Saudi Arabia, and the UAE), no other Arab nations
  - Services domestic regulation: Saudi Arabia and the UAE
  - Investment facilitation: Morocco, Saudi Arabia and Yemen

# Reflected in limited growth in regional value chains



- Pattern of selling intermediate products for further processing in other countries has not changed much in MENA, contra rest of the world
- Instead, non-regional supply chain integration has been increasing
- From perspective of benefitting from recent trend of derisking and reducing reliance on China this may be a positive
- But likely to require further reforms to facilitate trade and reduce policy uncertainty
- North America, East Asia & Pacific and Europe all have extensive network of deep trade agreements that do so

Source: De Melo and Twum, *Journal of African Trade*, 2021

## From regional trade to more flexible plurilateral cooperation?

- Premise: For regional initiatives to help overcome political economy forces that underlie internal conflicts and intra-regional tensions differences, trade agreements need to be complemented by domain-specific initiatives that involve actors with an economic stake In successful cooperation
- Such initiatives may (need to) include non-regional participants – i.e., constitute plurilateral arrangements
  - Including cooperation among BRICs members, facilitated by recent expansion to include Egypt, Iran, Saudi Arabia and UAE
- Many potential candidates:
  - Economic corridors; regional connectivity and integration of markets for energy; cooperation to increase access to fresh water (e.g., desalination linked to renewable energy investments), facilitating regional tourism, etc.
- Some recent steps in this direction can be observed

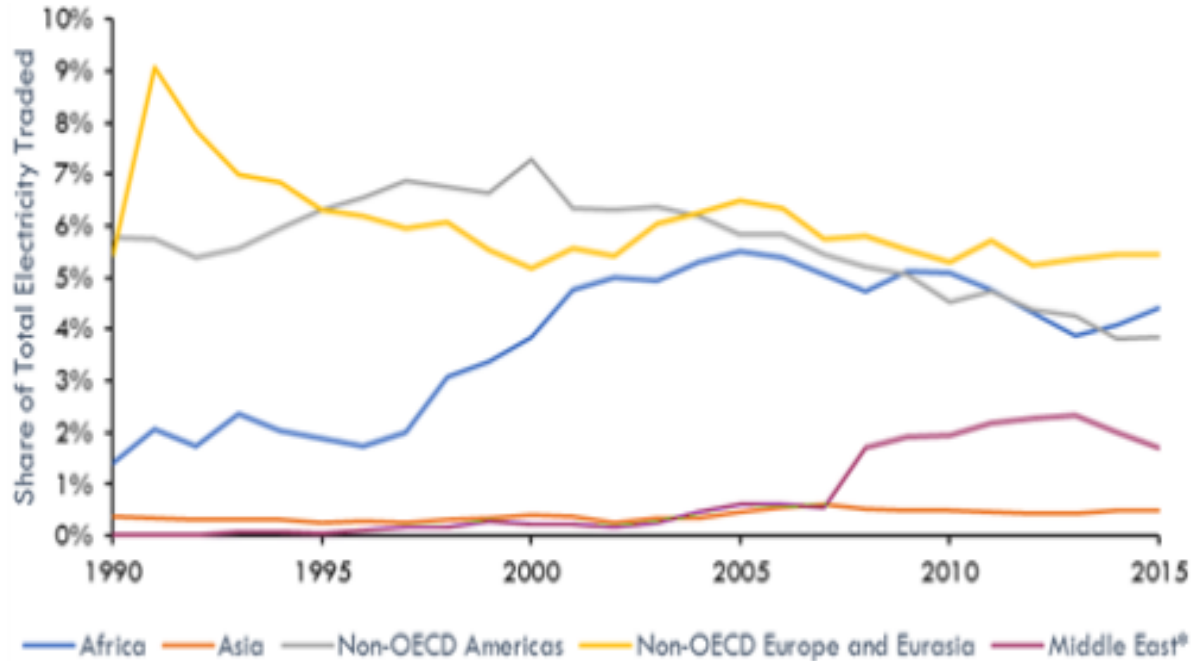


# 1. Economic Corridors and Connectivity Projects

- Proposed India-Middle East-Europe Economic Corridor (IMEC)
  - Not linked to trade agreements, but requires similar action non-tariff measures/transit regulation
  - Infrastructure-based project centred on UAE-Saudi-Jordan-Israel rail transport corridor
  - Includes services and energy trade focus: railway accompanied by cable for electricity and high-speed secure digital connectivity and pipeline for clean hydrogen export
  - Leverage GCC leadership in logistics services, port facilities, and “super-connector” airlines
- Bypass Russia and Iran; alternative and faster route to EU than Suez canal (diversification); complements China’s BRI
  - Russia in turn seeking to build transport corridors to India via Iran and to Europe via Arctic Sea. BRICs -- since Egypt, Iran, UAE and Saudi Arabia are among the new members
- Success requires mobilizing financing investments and sustained cross-border regional cooperation to adopt common standards and soft infrastructure
  - Project builds on PAFTA removal of tariffs (necessary condition), but much of what is found in deep PTAs elsewhere will need to be pursued for the corridor to operate efficiently
  - This may be facilitated by incentives of the countries and private actors involved to push reforms needed to realize potential benefits of corridor operation
- Feasibility of clearly conditional on settlement of war in Gaza

## 2. Connecting electricity markets

Share of electricity traded by region



- Only 2% of electricity produced in MENA is traded
- Utilization of extant cross-border transmission capacity is only 5–7%
- Less than 50% of generation capacity is utilized

Source: World Bank, The Value of Trade and Regional Investments in the Pan-Arab Electricity Market , 2021

- Currently, trade is sub-regional/bilateral/limited
  - Most developed in GCC: Power Exchange and Trade Agreement/GCC Interconnection Authority. Mostly used to deal with shocks on a barter basis
  - Mashreq: formal agreement between Egypt, Iraq, Jordan, Syria, and Turkey on interconnection
  - Maghreb: Algiers Declaration to work toward harmonizing regulatory and technical standards needed for a regional electricity market
- League of Arab States initiative to create a Pan-Arab electricity market (PAEM): reduce national system costs, better use of capacity & reserves to meet peak load demands
  - Connecting GCC to Mashreq/Turkey and creating a Maghreb market that allows integration into EU grid would also support exports of renewable energy
- 2017 MOU (16 states). PAEM Secretariat created in 2022. Agreed road map for implementation.
- Significant investment requiring private sector participation. Supported by WBG and Arab Fund.

### 3. Regional gas markets

- Region's share of global LNG exports in 2022 was 30%, but only 10% of gas exports are intra-regional
- No regional platform or partnerships
  - Gas Exporting Country Forum based in Qatar created to increase coordination and collaboration among leading gas producing members – not a regional body
  - Regional members: Algeria, Egypt, Iran, Libya, Qatar, UAE
- 2019/2020: Establishment of a East Mediterranean Gas Forum by Republic of Cyprus, Egypt, France, Greece, Israel, Italy, Jordan, and Palestine; based in Egypt
  - Goal: establish a regional gas market, enhance security of supply; coordinate resource development
  - A platform for structured policy dialogue on natural gas, leading to the development of a sustainable regional gas market that could unlock the full gas resource potential in the East Mediterranean region
  - Includes participation by national sectoral regulators (Regulatory Authority Advisory Committee) and private sector (Gas Industry Advisory Committee)
- Unclear prospects given contestation by Turkey and absence of larger regional suppliers, but in principle an example of plurilateral cooperation spanning producers (private and SOEs), regulators, exporting and importing states
- Potential model for a plurilateral initiative that includes more regional gas producers?
  - E.g., linked to the GCC-Mashreq rail/gas/digital corridor proposal

## 4. Critical minerals and raw materials

- Leverage rising global concern regarding access to essential supplies and critical materials needed to support energy transition and high-tech industries
  - Region has significant supply capacity: Saudi Arabia, Jordan, Morocco....
- Significant investment needed – potential for cooperation to address financial, energy, technical, skills & regulatory requirements
  - Share risks and costs with buyers through strategic partnerships
- Opportunity to attract downstream FDI in relevant sectors?
- Not clear regional cooperation is needed here but a regional initiative may help to capture scale economies, mobilize finance, develop infrastructure, logistics/transport and processing value chain
- Alternatively (or complementary) build on EU proposal for a Critical Raw Materials Club with a view to making this an operational partnership that reflects interests/needs of regional suppliers
  - Contra the Minerals Security Partnership (US, Australia, Canada, India, Korea, UK + several European states and the EU)

# Wrapping up

- Geopolitical dynamics and perceived need to increase resilience to natural shocks and weaponization of interdependence offers a potential opportunity
- See a mix of nascent domain-specific regional and plurilateral trade facilitation initiatives
  - Open question whether plurilateral initiatives that include non-regional partners will be better able to address political and political economy resistance to implementation
- Need to consider China, Russia and Iran – major suppliers of critical minerals with large connectivity projects in many of the areas that are salient to the region
  - Competition (redundancy) or complementary?
- Distributional implications of club-based cooperation need to be considered
  - Both within the club and for non-participating countries that perceive negative impact on their sectoral interests
- Some of the well-known challenges to provision of regional public goods apply
  - E.g., weakest link constraints; hold-up problems; balancing of national costs and benefits
- But antibodies to integration of regulatory regimes that inhibit deep PTAs may be less strong with sector-specific plurilateral cooperation as regulators are directly involved and there is less scope/need for issue linkages
- Many of the opportunities for regional/plurilateral cooperation conditional on settlement of war in Gaza and managing foreign policy differences across countries in the region